

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 EURE-00 AID-05 CEA-01 CIAE-00 COME-00

EB-07 FRB-03 INR-07 NSAE-00 CIEP-01 SP-02 STR-04

TRSE-00 LAB-04 SIL-01 SAM-01 OMB-01 L-02 SS-15 NSC-05

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FM USMISSION EC BRUSSELS

TO SECSTATE WASHDC PRIORITY 8930

INFO ALL EC CAPITALS 698

AMEMBASSY BERN

AMEMBASSY OSLO

AMEMBASSY STOCKHOLM

AMEMBASSY VIENNA

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PASS TREASURY AND FRB

E.O. 11652: N/A

TAGS: EFIN, EEC

SUBJECT: EC FINANCE COUNCIL MEETING--FRENCH STATEMENT REGARDING
RE-ENTRY INTO THE "MINI-SNAKE"

REF: EC BRUSSELS 4497 (NOTAL)

1. SUMMARY: FRENCH FINANCE MINISTER FOURCADE SUBMITTED AN
AIDE MEMOIRE ON THE FRENCH POSITION REGARDING ITS RE-ENTRY
INTO THE SNAKE TO THE EC FINANCE MINISTERS AT THE COUNCIL
MEETING ON MAY 20. THE MISSION HAS THE "OFFICIAL" ENGLISH
TRANSLATION OF THIS STATEMENT, WHICH WE HAVE REVISED FOR
CLARITY AFTER COMPARING IT WITH THE ORIGINAL FRENCH TEXT.
FOURCADE LISTED THREE "SUGGESTIONS" REGARDING RE-ENTRY:

1) THE SNAKE COUNTIRES SHOULD RESUME COORDINATED INTERVEN-
TION AGAINST THE DOLLAR AND SET FLEXIBLE TARGET RATES

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FOR SUCH INTERVENTIONS; 2) SNAKE COUNTRIES SHOULD SHARE

THE BURDEN OF INTERVENTIONS; 2) SNAKE COUNTRIES SHOULD SHARE THE BURDEN OF INTERVENTIONS TO KEEP CURRENCIES WITHIN THE SNAKE MARGINS; AND 3) SETTLEMENT PERIODS FOR VERY SHORT CREDITS SHOULD BE EXTENDED AND THESE CREDITS SHOULD BE REPAYED IN DOLLARS. AS A LONG-TERM MEASURE, FOURCADE ALSO SUGGESTED THAT COUNTRIES COULD TEMPORARILY "OPT-OUT" OF THE SNAKE, UNDER CERTAIN CONDITIONS. THIS STATEMENT HAS NOT BEEN RELEASED TO THE PUBLIC AND CONSEQUENTLY SHOULD BE FOR OFFICIAL USE ONLY. END SUMMARY.

2. BEGIN TEXT: MEMORANDUM ON THE OPERATION OF THE EUROPEAN MECHANISM TO NARROW EXCHANGE RATE MARGINS:

ON JANUARY 19, 1974, FRANCE TEMPORARILY SUSPENDED PARTICIPATION IN THE EUROPEAN MECHANISM TO NARROW MARGINS, WHICH WAS ESTABLISHED BY THE BASEL AGREEMENT OF MARCH 21, 1972. ON TWO OCCASIONS--SEPTEMBER 1973 AND JANUARY 1974--FRANCE EXPERIENCED ADVERSE CONSEQUENCE WHICH WERE CAUSED BY TWO FACTORS IN THE OPERATION OF THE MECHANISM. FIRST, COUNTRIES ARE REQUIRED TO INTERVENE WITH THEIR FOREIGN EXCHANGE RESERVES WHENEVER MARKET CONDITIONS CAUSE EXCHANGE RATES TO DIVERGE. SECONDLY, THIS DRAIN ON RESERVES IS EXASPERATED WHEN A CURRENCY'S RATE IS INFLUENCED BY CONFLICTING POLICIES AMONG EUROPEAN GOVERNMENTS AS TO WHAT SHOULD BE THE EXCHANGE RATE OF THE MOST IMPORTANT INTERNATIONAL CURRENCY, I.E., THE DOLLAR.

THIS IS WHY AT THE PRESENT MOMENT, WHEN IT HAS BEEN DECIDED THAT THE FRANC SHOULD RE-ENTER THE EUROPEAN MECHANISM TO NARROW MARGINS, THE FRENCH GOVERNMENT DESIRES TO BEGIN DISCUSSIONS ON CERTAIN MODALITIES OF THIS MECHANISM.

I. IN THE SHORT RUN, IT WOULD BE DESIRABLE TO DISCUSS THE FOLLOWING THREE POINTS:

1. CHANGES IN INTERVENTION RULES.

SINCE MARCH 1973 COUNTRIES WITH THE WEAKEST CURRENCIES HAVE BEEN OBLIGED TO INTERVENE WITHOUT ANY LIMIT IN ORDER TO STAY WITHIN THE MARGINS. THIS REQUIREMENT IS UNFAIR FOR TWO REASONS: 1) SOMETIMES THE RESPONSIBILITY FOR CURRENCY DIVERGENCIES RESTS WITH THE STRONG CURRENCY BECAUSE IT MAY BE THE OBJECT LIMITED OFFICIAL USE

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OF SPECULATION; AND 2) ONLY CURRENCIES AT THE MARGINS OF THE MECHANISM ARE CURRENTLY OBLIGED TO INTERVENE; OTHERS ARE EXCLUDED.

THIS IS NOT A EFFICIENT METHOD BECAUSE INTERVENTIONS LIMITED TO THE TWO CURRENCIES AT THE MARGINS MAY BE TOO LATE. INSTEAD, MORE TIMELY INTERVENTIONS IN DOLLARS ON A SYMMETRICAL BASIS TO SUPPORT CURRENCIES BEFORE THEY REACH THE MARGINS WOULD MORE

EFFECTIVELY STABILIZE MARKET CONDITIONS, AND WOULD
AVOID PUTTING THE FULL BURDEN ON THE WEAKEST CUR-
RENCY.

2. A CUMMUNITY LEVEL FOR THE DOLLAR.

THIS IS AN OPPORTUNE TIME TO RESUME COOR-
DINATED INTERVENTIONS AGAINST THE DOLLAR. THE
EXCHANGE RATE RELATIONSHIP WITH THE DOLLAR IS
IMPORTANT FOR BOTH MONETARY AND COMMERCIAL REASONE.
AUTHORITIES' VIEW TOWARD THE DOLLAR
SHOULD CONSEQUENTLY BE COORDINATED AS MUCH AS
POSSIBLE. INTERVENTION ZONES WITH RESPECT TO THE
DOLLAR MIGHT BE CONSIDERED. CENTRAL BANKS WOULD
FREQUENTLY CONSULT TO SET THE LEVEL OF THESE ADJUST-
ABLE ZONES.

3. CHANGES IN INTERVENTION REQUIREMENTS.

LIABILITIES RESULTING FROM CENTRAL BANK
INTERVENTIONS SHOULD CONTINUE TO BE DENOMINATED IN
UNITS OF ACCOUNT OF THE EUROPEAN MONETARY COOPERATION

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FUND (EMCF). TWO CHANGES IN THE REGULATIONS ESTABLISHED IN 1972 MIGHT BE CONSIDERED.

FIRST, VERY SHORT TERM CREDITS (I.E., CREDITS WITH A MATURITY OF ONE MONTH AFTER THE END OF THE MONTH OF INTERVENTION) COULD BE AUTOMATICALLY EXTENDED FOR A THREE-MONTH PERIOD. AN ADDITIONAL THREE-MONTH EXTENSION COULD BE GRANTED IF THE CREDITOR AGREES. AN EXPANDED CREDIT SYSTEM WOULD BE ADVANTAGEOUS BECAUSE OF THE VOLATILITY OF CURRENCY MOVEMENTS WITHIN THE EUROPEAN MECHANISM. TO COMPENSATE FOR THIS EXTENSION, A CEILING COULD BE PLACED ON BOTH CREDIT AND DEBIT POSITIONS. THIS WOULD PROVIDE FOR AN EVENTUAL RE-EXAMINATION OF THE SITUATION OF THOSE COUNTRIES WHICH CONTINUE TO ACCUMULATE EITHER CREDITS OR DEBITS.

SECONDLY, COUNTRIES ARE PRESENTLY REQUIRED LIMITED OFFICIAL USE

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TO REPAY THEIR DEBTS IN PROPORTION TO THEIR SEVERE ASSETS, I.E., GOLD AND IMF ASSETS ON THE ONE HAND, AND FOREIGN CURRENCY RESERVES ON THE OTHER. THIS REQUIREMENT CANNOT BE CONVENIENTLY APPLIED WITHOUT A SYSTEM OF MAKING PAYMENTS IN GOLD AND CONSEQUENTLY IT SHOULD BE ELIMINATED. COUNTRIES SHOULD BE ABLE TO SETTLE THEIR DEBTS IN GOLD AT MARKET RELATED PRICES, IF THEY DESIRE TO DO SO AND THE CREDITOR AGREES.

II. IN THE LONG TERM, OTHER MEASURES MIGHT BE UNDERTAKEN.

FRANCE SUBMITTED DOCUMENTS MAKING SUGGESTIONS ON SEVERAL MATTERS IN SEPTEMBER AND OCTOBER 1974. BRIEFLY THESE ARE:

1. TO FACILITATE EXCHANGE RATE CHANGES, A NEW SCHEME MIGHT BE USED IN THE MANAGEMENT OF EUROPEAN CURRENCY FLUCTUATIONS. A REFERENCE OR PIVOT RATE COULD BE ADOPTED WHICH WOULD BE MORE PRAGMATIC AND FLEXIBLE THAN THE IMF CENTRAL RATE. UNDER THIS SCHEME, IT WOULD NOT BE NECESSARY TO CHANGE PAR VALUES OR TO FLOAT OUTSIDE OF THE SNAKE, IN TIMES OF MARKET DISTURBANCES. INSTEAD, THE REFERENCE OR PIVOT RATE COULD BE CHANGED AND THEREBY POSSIBLE ADVERSE PUBLIC REACTION COULD BE AVOIDED.

2. THE REFERENCE RATE COULD BE CHANGED AFTER A PERIOD OF STAND-BY (I.E., NON-COMPLIANCE). DURING THIS PERIOD A CURRENCY WOULD FLOAT FREELY IN ORDER THAT ITS NEW RATE MIGHT BE DETERMINED IN A REALISTIC FASHION. ONE COULD ALSO CONCEIVE OF DETERMINING TEMPORARY, EXPANDED MARGINS FOR CURRENCIES

THAT ARE NOT COMPLYING WITH THE NORMAL MARGINS. THE COMMUNITY WOULD STEP UP THE INTENSITY OF ITS SUPERVISION OF THE COUNTRY CONCERNED AS THE AMOUNTS OF THE MARGINS ARE INCREASED.

3. THE AMOUNT OF FLUCTUATION AROUND THE PIVOT RATE SHOULD BE DISCUSSED. THE MARGIN COULD REMAIN AT THE 2.25 PERCENT FIXED BY THE BASEL AGREEMENT OR IT COULD BE EXPANDED. THE MARKED DIFFERENCES IN MEMBER STATES' FOREIGN EXCHANGES RESERVES SHOULD JUSTIFY AN EXPANSION OF THE EXISTING MARGINS FOR THE PRESENT TIME. EXPANDED MARGINS WOULD ALSO LIMITED OFFICIAL USE

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ENABLE OTHER MEMBER STATES TO REJOIN EVENTUALLY THE SNAKE.

4. THE EUROPEAN MARGIN MIGHT BE DEFINED AS EACH CURRENCY'S MAXIMUM VARIATION FROM THE VALUE OF THE EC UNIT OF ACCOUNT (U.A., A MARKET BASKET OF EC CURRENCIES). THE COUNCIL ESTABLISHED THIS AS THE U.A. FOR THE EUROPEAN DEVELOPMENT FUND AND THE EUROPEAN INVESTMENT BANK.

5. AS SUGGESTED BY THE COMMISSION, THE EC SHORT-TERM CREDIT FACILITY SHOULD BE EXPANDED BY A SIGNIFICANT AMOUNT, SUCH AS UP TO 10 BILLION U.A. (\$12.1 BILLION). SUCH AN EXPANSION WOULD ENHANCE THE FUNCTIONING OF ALL EUROPEAN MECHANISMS. SIMILARLY, THE EC MEDIUM TERM CREDIT FACILITY SHOULD ALSO BE INCREASED. END TEXT.

3. COMMENT: EC COMMISSION OFFICIALS INDICATE THAT A NUMBER OF THE ABOVE SUGGESTIONS ARE NOT CLEARLY STATED. THEY EXPECT TO OBTAIN CLARIFICATION ONCE DISCUSSIONS WITH THE FRENCH BEGIN. END COMMENT.
GREENWALD

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